Vol 311

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

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No. 460

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JOHN SPENCER, Trustee in Bankruptcy of Van Arman Cereal Company, a Michigan corporation, Bankrupt, Petitioner,

vs.

HIRAM WALKER & SONS GRAIN CORPORATION, LTD., a Canadian corporation, Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

(Italics ours)

To The Honorable, The Chief Justice and Associate Justices of The Supreme Court of The United States:

Your petitioner, John T. Spencer, trustee in Bankruptcy of Van Arman Cereal Company, a corporation, respectfully prays that a Writ of Certiorari issue to the Circuit Court of Appeals for the Sixth Circuit to review a decree of that Court entered May 11, 1940* affirming a decree of the

*Petition for rehearing denied June 27, 1940.

United States District Court for the Eastern District of Michigan, Southern Division. A certified transcript of the record in the case, including the proceedings in said Circuit Court of Appeals is furnished herewith in accordance with Rule 38, Paragraph 1, of the Rules of this Court.

STATEMENT OF MATTERS INVOLVED

Van Arman Cereal Company was adjudicated bankrupt in the District Court of the United States for the Eastern District of Michigan, Southern Division, on August 23, 1937, on an involuntary petition filed on August 11, 1937, (R. 66). Assets were scheduled at $6000.00 and liabilities at $53,940.28 (R. 66-71). The four months period before bankruptcy began on April 11, 1937.

In December, 1936, the bankrupt sold its entire output (beer flakes) through the Products Company. About the middle of April, 1937, it began selling its brewery customers direct and continued to do so until July 28, 1937, when a state court receiver was appointed in voluntary proceedings.

In November, 1936, bankrupt had assigned its present and future accounts to National Bank of Detroit, pursuant to resolution of its board of directors, which assignment was in force until after June 26, 1937, when the bank was paid off in full.

Hiram Walker & Sons Grain Corporation, Limited, doing a grain business in the United States, hereinafter referred to as Walker, respondent, a creditor having a claim of approximately $47,000.00 in May, 1937 (R. 27) entered Van Arman's place of business in Detroit in May or June, 1937, for the stated purpose of making an audit of the bankrupt's books, which was immediately made

(R. 86, 96, 105) and thereafter Walker's auditors remained continuously in the premises of the bankrupt and dominated its business until the state court receiver was appointed (R. 107). Walker's auditors directed the bankrupt to pay Walker substantial sums (R. 107-8) and the bankrupt paid Walker by checks on its bank account, $15,191.80 in May, $26,040.01 in June, and $26,809.65 in July (R. 61, Ex. 20, page 160). During August, 1937, after adjudication, Walker collected a minimum of $8870.63 from accounts receivable of the bankrupt, which it claimed had been assigned to it (Ex. 20, p. 160, R. 57, 60, 61).

On June 26, 1937, Walker procured a written assignment of accounts receivable, as security, from the president and assistant secretary of the bankrupt, dated as of March 12, 1937, *and which purported to be based on a resolution of March 12, 1937* (R. 12),

Petitioner, as trustee in bankruptcy, filed a bill in equity in the District Court of the United States for the Eastern District of Michigan against Walker to recover sums obtained as preferences and fraudulent conveyances, alleging that the said assignment of accounts receivable within the four months period was void, and that the resolution of March 12th (antedating the four months period) did not authorize an assignment of accounts receivable.

Walker waived its claims under the assignment of June 26th and the resolution of March 12th, declaring those instruments to be superfluous, and relied *solely* and *exclusively* on an alleged oral understanding (not authorized by resolution of the bankrupt's board of directors) between the president (sales manager) of the bankrupt and the general manager of Walker *in December, 1936* (R. 35).

The oral understanding was, as found by the trial court, "that Walker would furnish grits to Van Arman for

processing, with the understanding that the grain, either as grits or beer flakes, *would remain the property of Walker,* and Van Arman was *to instruct* the Products Company to remit all payments directly to Walker."

Michigan Compiled Laws '29, par. 9550, provides that a conditional sales contract covering goods intended for resale is void, unless in writing, and filed as a chattel mortgage.

In January, after the alleged oral understanding, Walker demanded field warehousing in bankrupt's premises and warehouse receipts, as security, but field warehousing could not be arranged by the bankrupt (R. 83).

In March Walker demanded that the bankrupt sell on sight draft bill of lading and that the sight drafts be deposited in Walker's account (R. 83, 85). *The resolution of March 12th was adopted to carry out this arrangement.**

The bankrupt could not sell on sight draft bill of lading and this plan was abandoned, no drafts having been so deposited.

In April Walker demanded a written assignment of accounts as security, which the president of the bankrupt

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*The resolution reads as follows:

"Resolved, that the officers of the Van Arman Cereal Company enter into an arrangement with the National Bank of Detroit to deposit all drafts received from sales of finished products to the credit of Hiram Walker & Sons Grain Corporation, Limited, and that the said National Bank of Detroit be authorized to remit the proceeds of said drafts direct to Hiram Walker & Sons Grain Corporation, Limited. Said officers are further authorized to consent to a charge for handling said drafts of 3c per cwt to Hiram Walker & Sons Grain Corporation."

refused to execute, because warned not to do so by the bank (R. 84).

The December oral understanding was modified about the middle of April by a *second oral understanding* under which Walker was to have an assignment subject to the assignment to the bank, and the bankrupt was to collect the accounts as agent of Walker.

First specific reference to an assignment of accounts was made in the April conversation.

The oral understanding of December entered the April conversation as a void conditional sale and emerged as an assignment of accounts.

The oral understanding for an assignment which Walker claims was in existence prior to March 12th came into being in April.

From April on bankrupt collected the brewery accounts, deposited the same in its own bank account and disbursed the same *through its own checks,* paying its operating expenses therefrom, but the bulk thereof to Walker *from its cash* and *not its accounts,* under Walker's orders (R. 108).

Walker claimed an absolute assignment (title) under the *oral understanding of December* and expressly disclaimed an equitable assignment (lien), and did not rely on the April understanding, which was not in issue.

In its answer Walker contradicted the claims asserted under the alleged oral agreement, *of a then present exist-*

ing assignment in December, and alleged the assignments came into existence within the four months period:*

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*In paragraph 11 of appellee's answer (R. p. 26) it is alleged:

> "* * * that the said grits were at all times delivered to the Van Arman Cereal Company under an agreement, whereby the grits were to remain the property of the defendant corporation until processed and sold by the Van Arman Cereal Company, *at which time* the defendant corporation was *to be secured* by an assignment of the accounts receivable, created by the sales of said grits."

Further in said paragraph the appellee alleges,

> "* * * This defendant further admits that there is due to it from the Van Arman Cereal Company the sum of Twenty-Four Thousand Four Hundred Fifty-nine and 96/100 ($24,459.96) Dollars as of August 23, 1937, and further admits that there was assigned to it, as partial security for the said indebtedness, accounts receivable having a face value of Thirteen Thousand Seven Hundred Three and 05/100 ($13,703.05) Dollars and an actual value of approximately Ten Thousand ($10,000.00) Dollars, but denies that the said assignment was received on June 26, 1937, and charges the truth to be that the assignment *was as of the dates of the inception of said accounts receivable.*"

In paragraph XXII (R. p. 35) appellee alleges:

> "Further answering paragraph 22, this defendant admits that on June 26, 1937, a written assignment dated June 26, 1937, but as of March 12, 1937, was executed by the officers of the Van Arman Cereal Company to this defendant, but charges the truth to be that the execution of the said instrument was merely to put into proper form the assignment which had *been in existence* on *March 12, 1937.*"

And subsequently in the same paragraph:

> "Further answering paragraph 22, this defendant charges the truth to be that when the agreement for the assignment of accounts was entered into *in connection with the sale of the Van Arman Cereal Company of its products to the general public,* the Van Arman Cereal Company especially requested this defendant to permit it, the Van Arman Cereal Company to make collection of the said accounts, so that its standing with its customers would not be injured by reason of its customers knowing that its accounts receivable had been assigned."

The sole issue in the case was whether an assignment of future accounts arose out of the oral understanding of December, and whether the written assignment of June 26th was in confirmation thereof.

Both courts below went beyond the issue, confused the controlling understanding of December with the understanding of April, and decided the case on the April understanding, holding that a lien was created thereby.

REASONS FOR GRANTING THE WRIT

1. The court below has decided important questions of local law in conflict with the decisions of the Supreme Court of Michigan *In re Frigidaire Sales Corporation v. Pospeshil,* 257 Mich. 688, and the Statutes of Michigan, and in *Morse v. Allen Estate,* 99 Mich. 303.

2. The decision of the court below is in conflict with the decisions of other Circuit Courts of Appeals on the same matter.

3. The court below has decided an important question of general law in a way probably untenable, or in conflict with the weight of authority.

PRINCIPAL QUESTIONS PRESENTED

1. Under Michigan law can the rights of a third party (Trustee in Bankruptcy) be adversely affected by the creation of an equitable assignment or lien?

The Court below answered this question Yes.
The answer should be No.

2. Does a written assignment of present and future accounts receivable, taken within four months of bankruptcy amount to a "confirmation" of an oral agreement, entered into before the four months period, when the oral understanding provided for a conditional sale, void under the laws of Michigan, plus an undertaking by the bankrupt, that it would instruct its customer to pay proceeds of sales to appellee, the bankrupt thereafter disregarding this undertaking and collecting substantial monthly sums from its debtor direct?

The Court of Appeals answered this question Yes.
The answer should be No.

3. Can a creditor, relying solely and exclusively on a December oral understanding as justification of a written assignment of accounts receivable, taken in the following June, within the four months period, shift its position when its claims under the oral understanding became untenable and have an equitable lien created in its behalf, based on another oral understanding, claimed to have been entered into in April, for an assignment of accounts?

The Court of Appeals answered this question Yes.
The answer should be No.

4. Can a creditor "run with the fox and ride with the hounds" by shifting its position three times in a single

case and defeat the trustee's title and superior lien by an equitable lien, created without regard to the hitherto well understood legal requirements of an equitable lien?

(In this case appellee based the written assignment of accounts (within four months) on a resolution dated March 12th. When its position became untenable, because the resolution did not authorize an *assignment of accounts,* appellee sought to abandon the written assignment and the resolution and relied exclusively on an oral understanding *in December.* When the December understanding became untenable, because it provided for a void conditional sale and a mere direction by the bankrupt to its customer to pay money to appellee, which the bankrupt disregarded by collecting substantial sums itself, appellee sought to abandon the December oral understanding and shifted to an April understanding, and succeeded in so doing, and succeeded in establishing an equitable lien on the whole record.)

The Court of Appeals answered the foregoing question Yes.

The answer should be No.

STATUTES INVOLVED

Act 64 of the Public Acts of Michigan for 1935, being Compiled Laws '29, Par. 9550; C. L. '15, Par. 11912; 14 Michigan Statutes Annotated, Par. 19381, provides as follows:—

> "Conditional sale of property for resale; Written contract, filing discharge. Section 1. Whenever any personal property is sold and delivered to any person, firm or corporation regularly engaged or about to engage in the business of buying and selling such personal property, with the condition affixed to the sale that the title thereto is to remain in the vendor of such personal property until the purchase price thereof shall have been paid, with the agreement express or implied, that the same may be resold, every such conditional sale in order for the reservation of title to be valid except as between the vendor and vendee shall be evidenced in writing and the written contract of every such conditional sale or a true copy thereof shall be filed and discharged in the same manner as chattel mortgages are required to be filed and discharged."

The Pertinent parts of the chattel mortgage statute of Michigan (C. L. '29, Par. 13424; C. L. '15, Par. 11988; 19 Michigan Statute Annotated Par. 26.929 provide as follows:—

> "Every mortgage or conveyance intended to operate as a mortgage of goods and chattels which shall hereafter be made which shall not be accompanied by an immediate delivery and followed by an actual and continued change of possession of the things mortgaged, shall be absolutely void as against the creditors of the mortgagor, and as against subsequent purchasers or mortgagees in good faith, unless the mortgage or a true copy

thereof shall be filed in the office of the register of deeds of the county where the goods or chattels are located, and also where the mortgagor resides, except when the mortgagor is a non-resident of the state, when the mortgage or a true copy thereof shall be filed in the office of the register of deeds of the county in which the property is located; and unless the mortgagor or mortgagee named in such mortgage or conveyance intended to operate as a mortgage, or some person having knowledge of the facts shall, before the filing of the same, make and annex thereto an affidavit setting forth that that consideration of said instrument was actual and adequate, and that the same was given in good faith for the purposes in such instrument set forth. No officer shall receive such instrument or file the same in his office until such affidavit is made and annexed thereto; Provided, however, That where the original instrument bears such affidavit annexed thereto, it shall be sufficient that a copy of such instrument offered for filing bears also a true copy of such affidavit. Every person who shall knowingly make any false statement in any such affidavit, upon conviction thereof shall be deemed guilty of the crime of perjury; Provided, That in case of corporations engaged in transporting passengers or freight over fixed routs, or conveying electricity or gas or telephonic or telegraphic communications, all that is or shall be required is the filing of the copy of such mortgage with the register of deeds of each county through which the lines or property thereof passes.

Copies of any such mortgage or conveyance intended to operate as a mortgage and of the affidavit thereto attached may, with like effect, be filed in the office of the register of deeds of the county to which such goods or chattels or any portion thereof may thereafter be removed. This provision shall not be construed as altering or affecting the foregoing requirements as to the office or offices in which such mortgage or copy shall be filed.

Any holder of any such mortgage or other lien may legally waive his priority of lien by discharge or other appropriate written instrument filed in the office where such mortgage is filed. An assignment in writing of any such mortgage may be filed in the office wherein the mortgage so assigned is filed.

Every register of deeds shall accept and file in his office in the manner required by this act, every mortgage or copy thereof to which is attached the affidavit or copy thereof herein required, and every renewal affidavit, assignment, or discharge of any mortgage, which may be tendered to him for filing by any person, accompanied by the fee herein required."

Wherefore your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this court directed to the United States Circuit Court of Appeals for the Sixth Circuit, sitting at Cincinnati, Ohio, commanding said court to certify and send to this court on a day to be designated, a full and complete transcript of the record of all proceedings of the Circuit Court of Appeals had in this cause, to the end that this cause may be reviewed and determined by this court; that the decree of the Circuit Court of Appeals for the Sixth Circuit affirming the decree of the trial court be reversed and that the petitioner be granted such other and further relief as may seem proper.

MAX KAHN,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION

I.

OPINIONS BELOW

The opinion of the District Court has not been officially reported, but is printed in full in the record (R. 66).

The opinion of the Circuit Court of Appeals has not been officially reported, but is printed in full in the record (R. 180).

II.

JURISDICTION

The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended by Act of February 13, 1925 (28 U. S. C. Sec. 347A). The date of the decree of the Circuit Court of Appeals for the Sixth Circuit (R. 180) sought to be reviewed was May 11, 1940. The date of the order of said Circuit Court of Appeals denying the petition for rehearing was June 27, 1940 (R. 191).

III.

STATEMENT OF THE FACTS

The facts have been fully set forth under the caption "Statement of Matters Involved" which is hereby adopted.

IV.

SPECIFICATION OF ERRORS TO BE CHARGED

The Circuit Court of Appeals erred:—

1. In holding that the oral understanding created a lien superior to the trustee's title and lien.

2. In deciding the case on the April understanding instead of the December understanding and immaterial facts not within the issue.

3. In holding that an assignment of accounts receivable arose out of the oral understanding of December, 1936.

4. In affirming the decree of the District Court.

V.

SUMMARY OF ARGUMENT

1. The rights of the parties under the oral understanding of December, 1936, are to be determined by the laws of Michigan. Under the law of Michigan equitable assignments or liens will not be created by courts to aid a litigant. Under the law of Michigan the rights of third parties cannot be adversely affected by the creation of an equitable assignment or lien.

2. The oral understanding of December, 1936, provided for a conditional sale, void under the laws of Michigan, because not in writing and filed as a chattel mortgage. It was void as against the trustee's statutory lien. Appellee could not have reclaimed any of the raw materials sold the bankrupt under this void contract. By what feat of *ledger de main* can appellee obtain proceeds of sale of this raw material from the *bank* account of the bankrupt when

it could not reclaim the merchandise itself? The written assignment of June 26th has no connection whatsoever with the oral understanding of December, 1936, and the written assignment of June was not in confirmation thereof but a new contract created within the four months period and void for that reason.

3. Under the pleadings in this case appellee is confined to the oral agreement of December, 1936, and if an equitable lien arose that is good against the trustee in bankruptcy it must have arisen out of the bankrupt's undertaking to instruct its customer to pay proceeds of sales to appellee, which amounted to nothing more than an agreement to direct the payment of money out of a particular fund which, under the weight of authority, is insufficient to create an assignment *in praesenti*. The fact that the bankrupt disregarded this understanding and collected substantial sums monthly of its accounts from its customer proves conclusively that the bankrupt did not part with title in the accounts in December.

VI.

ARGUMENT

The Court Below Has Decided Important Questions of Local Law in Conflict With the Decisions of the Supreme Court of Michigan

The rights of the parties under the oral understanding of December, 1936, are to be determined by the law of Michigan.

> *Lone Star Cement Corporation v. Swartwout,* 93 Fed. 2nd (C. C. A. 4) 767, 770.

Under Michigan law equitable liens or assignments can not be created by courts to aid a litigant.

> *Frost v. Atwood,* 73 Mich. 67, 73.
> *Dehn v. Dehn,* 170 Mich. 407, 13.
> *Adrianse v. Rutherford* (Cooley, J.), 57 Mich. 170, 4.
> *Kelly v. Kelly,* 54 Mich. 30, 47.
> *Richards v. Shingle Co.,* 74 Mich. 57, 62.
> *Scott v. Freeman,* 227 Mich. 541, 3.
> *Fredericks Lumber Co. v. Evans,* 266 Mich. 486.
> *Cheff v. Haan,* 269 Mich. 593, 8.
> *Whitehead v. Barker,* 288 Mich. 19, 27.

Under the law of Michigan rights of third parties cannot be adversely affected by the creation of an equitable assignment or lien.

> *Morse v. Allen Estate,* 99 Mich. 303, 306.
> *Grand Rapids Trust Co. v. Reliable Coal and Mining Co.,* 238 Mich. 248.

An equitable assignment or lien cannot arise out of a void conditional sale contract against a trustee in bank-

ruptcy. Under such a contract the merchandise sold cannot be reclaimed, much less the proceeds of sale.

Frigidaire Sales Corporation v. Pospeshil, 257 Mich. 688.

In all the cases relied upon by the lower court there were *written contracts* that *provided for* an assignment of accounts and no question was raised as to the existence of the contracts but as to their effect.

Greey v. Dockendorf, 231 U. S. 513, 34 S. Ct. 166; 58 L. Ed. 339, was decided before the 1910 amendment to the Bankruptcy Act, Sec. 47 a (2) giving a trustee in bankruptcy the highest type of lien known to the law, went into effect.

In *Union Trust Co. v. Bulkley,* 150 Fed. 510, all parties conceded that a present assignment of accounts was effected.

In *In re United Fuel & Supply Co.,* 250 Mich. 325, the court points out that the effect of the arrangement was to *create a preference.* As the case arose under state law and not in bankruptcy the preference was valid. Attention is called to the dissenting opinion in this case. The case holds that the right of the assignor to collect the accounts and remit to the assignee from time to time did not defeat the *transfer of title* effected under the prior *written* contract.

Under the December oral understanding, in the case under consideration, the claimed assignor (bankrupt) was not given the right to collect the accounts from the Products Company, pursuant to an arrangement to remit the money to the assignee (appellee). Appellee contends that the oral December understanding, involving no more than an undertaking by the bankrupt *to instruct* the Products Company to remit moneys to the assignee, not lived up to, constituted a *then present assignment* and a *transfer of title* in and to the accounts. The lower courts sustained this contention.

An undertaking to direct the payment of money out of a particular fund does not constitute an assignment of accounts.

In re Stiger, 209 Fed. 148 (C. C. A. 3), aff'g 202 Fed. 791.

B. Kuppenheimer v. Mornin (C. C. A. 8), 78 Fed. 2nd 261, 5; 101 A. L. R. 75.

Lone Star Cement Corporation v. Swartwout (C. C. A. 4), 93 Fed. 2nd 767, 771.

The Decision of the Court Below in This Case Is In Conflict With the Decisions of Other Circuit Courts of Appeal on the Same Matters

Lone Star Cement Corporation v. Swartwout (C. C. A. 4), 93 Fed. 2nd 767, 770.

In re Stiger (C. C. A. 3), 202 Fed. 791, aff'g 209 Fed. 148.

In re Friedman (C. C. A. 2), 72 Fed. (2nd) 412.

B. Kuppenheimer v. Mornin (C. C. A. 8), 78 Fed. (2nd) 261.

Scott County Milling Co. v. Grayson (C. C. A. 5), 88 Fed. (2nd) 190.

Reliance Shoe Co. v. Manly (C. C. A. 4), 25 Fed. (2nd) 381.

Ramsey-Milburn Co. v. Eaves (C. C. A. 8), 283 Fed. 776.

The Court Below Has Decided An Important Question of General Law in a Way Probably Untenable or in Conflict With the Weight of Authority

1. An undertaking to instruct the Products Company to remit moneys to appellee is nothing more than an undertaking to direct payment out of a specific fund and does not constitute an assignment of accounts, giving the claimed assignee an equitable lien superior to the trustee's title and statutory lien.

Christmas v. Russell, 14 Wall. 69, 71; 29 Law Ed. 762.

Walker v. Brown, 165 U. S. 654, 17 S. C. 453; 41 Law Ed. 865.

Barnes v. Alexander, 232 U. S. 117, 34 S. C. 276; 58 Law Ed. 530.

Lone Star Cement Corporation v. Swartwout, 93 Fed. 2nd (C. C. A. 4) 767, 770.

B. Kuppenheimer v. Mornin (C. C. A. 8), 78 Fed. 2nd 261, 101 A. L. R. 75 and note.

In re Stiger (C. C. A. 3), 202 Fed. 791, aff'g 209 Fed. 148.

2. The oral conditional sales contract of December, 1936, being void under the laws of Michigan, appellee could not recover the merchandise itself from the trustee, much less the proceeds thereof from the bankrupt's bank account before the filing of the petition in bankruptcy, and the proceeds of bankrupt's accounts receivable after the filing of the petition in bankruptcy.

In re Mutual Motors Company, 260 Fed. 341.

Frigidaire Sales Corp. v. Pospeshil, 257 Mich. 688.

Scott County Milling Co. v. Eggleston (C. C. A. 5), 45 Fed. (2nd) 502.

Reliance Shoe Co. v. Manly (C. C. A. 4), 25 F. (2nd) 381.

In re United States Electrical Supply Co., 2 Fed. (2nd) 378.

Ramsey-Milburn Co. v. Eaves (C. C. A. 8), 283 Fed. 776.

CONCLUSION

The question involved in this case is not whether a valid oral assignment of accounts can be made under the laws of Michigan, but whether under the December oral understanding claimed, a then present assignment, passing title, was effected, that would justify appellee in obtaining the moneys that it did, within the four months' period, from the bankrupt's bank account and out of the bankrupt's accounts receivable, after the filing of the petition in bankruptcy.

The lower court, through a desire to render what it considered equitable justice to appellee, because it had furnished the essential raw material required for the bankrupt to operate, created an equitable lien in a case where an equitable assignment was asserted, overlooking that other creditors, who had likewise furnished just as necessary raw materials, but in smaller amounts, with equal equities, were adversely affected to the extent of approximately $20,000.

The court overlooked that the oral contract, relied on by appellee, arose out of the December understanding, and instead of confining the issue to that understanding, the court found that an equitable lien arose, without specifying how or when it was created. By so doing the court defeated the trustee's title in the money and accounts and the superior specific and prior lien granted to the trustee under the 1910 amendment to the Bankruptcy Act, being Section 47a(2); 11 U. S. C. A. Sec. 75(a)2.

Respectfully submitted,

MAX KAHN,
Counsel for Petitioner.